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BEFORE THE ARIZONA CORPORATION COMMISSION

Arizona Corporation Commission

COMMISSIONERS**DOCKETED**

AUG 17 2005

JEFF HATCH-MILLER, Chairman
WILLIAM A. MUNDELL
MARC SPITZER
MIKE GLEASON
KRISTIN K. MAYES

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF
ARIZONA ELECTRIC POWER COOPERATIVE,
INC. FOR AUTHORITY TO ISSUE DEBT.

DOCKET NO. E-01773A-04-0793

DECISION NO. 68065**ORDER**

Open Meeting
July 12 and 13, 2005
Phoenix, Arizona

BY THE COMMISSION:

Having considered the entire record herein and being fully advised in the premises, the Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

* * * * *

FINDINGS OF FACT

1. Arizona Electric Power Cooperative, Inc. ("AEPCO") is a non-profit electric generation cooperative that supplies the power needs of its Class A, Class B, and Class C members.

2. On November 4, 2004, AEPCO filed an application with the Commission requesting authorization to borrow an amount not to exceed \$4.9 million from the National Rural Utilities Cooperative Finance Corporation ("CFC") and to secure interim financing from CFC in an amount not to exceed \$3.5 million to be replaced by a permanent loan from Federal Financing Bank ("FFB") in an amount not to exceed \$3,050,000.

3. On January 6, 2005, AEPCO published notice of its application in the *Arizona Daily Star/Tucson Citizen*, and on January 7, 2005 in the *Kingman Daily Miner*, newspapers of general circulation in its service area.

4. On June 14, 2005, Commission Utilities Division Staff ("Staff") filed a Staff Report that recommends conditional approval of the application.

1 5. On June 23, 2005, AEPCO filed a letter responding to the Staff Report, waiving its ten
2 day exception period, and requesting that this matter be decided by the Commission at the July Open
3 Meeting.

4 6. The proceeds of the \$4.9 million CFC financing will be used to close the inactive
5 combustion waste disposal facility at AEPCO's Apache generating station. The interim loan from
6 CFC will be used to build a low volume wastewater pond at the Apache station, and the FFB loan
7 will replace the interim loan, when permanent financing becomes available.

8 7. The proposed \$4.9 million CFC loan will have a term of 10 years and the interest rate
9 will be determined by the published CFC ten year long-term debt rate at the time of the loan
10 issuance.¹ The interim \$3.5 million CFC loan has a maximum term of two years and will be at the
11 published CFC long-term variable rate at the time of issuance. The term of the \$3,050,000 FFB loan
12 is 30 years, with a two year principal deferment based upon a maturity of December 31, 2035. The
13 interest rate will be determined daily by the United States Treasury and the Rural Utilities Service
14 will add 1/8 of one percent to that rate.

15 8. According to the Staff Report, as of November 1, 2004, AEPCO's capital structure is
16 composed of 6.3 percent short-term debt, 89.7 percent long-term debt and 4.0 percent equity. After
17 this financing, AEPCO's long-term debt would increase to 89.9 percent and its equity would decrease
18 to 3.8 percent.

19 9. Based upon the test year in AEPCO's pending rate application, Docket No. E-
20 01773A-04-0528, Staff concluded that the additional debt requested herein would result in a Debt
21 Service Coverage ("DSC") of 0.78 and a Times Interest Earnings Ratio ("TIER") of 0.65.² These pro
22 forma ratios indicate that AEPCO would not have adequate earnings and cash flows to meet all
23 obligations. However, for purposes of this financing request, Staff conducted its financial analysis
24 based upon the agreed upon recommended rates in AEPCO's pending rate application. Using those

25 ¹ As of December 7, 2004, the rate was 6.25 percent.

26 ² TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means
27 that operating income is greater than interest expense. A TIER of less than 1.0 is not sustainable in the long term but does
28 not mean that debt obligations cannot be met in the short term. DSC represents the number of times internally generated
cash will cover required principal and interest payments on long-term debt. A DSC ratio greater than 1.0 indicates that
operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations
cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

1 recommended rates, the pro forma effect of the proposed CFC and FFB loans on AEPCO's financial
2 ratios would result in a DSC of 1.01 and a TIER of 1.54. Staff concluded that those pro forma ratios
3 would allow AEPCO to have earnings and cash flows to meet all obligations.

4 10. Staff visited AEPCO's Apache plant in conjunction with this financing application and
5 AEPCO's pending rate application. Staff found that a new low volume waste water evaporation pond
6 is needed once the old combustion waste disposal facility is retired to comply with Arizona
7 Department of Environmental Quality and Arizona Department of Water Resources' requirements.
8 Staff found the cost of the facility improvements to be reasonable and appropriate.

9 11. The Staff Report indicates that there are no outstanding compliance issues.

10 12. Staff concludes that a finding: that issuance of long-term debt for \$4.9 million to close
11 the inactive combustion waste disposal facility; that issuance of the interim debt for \$3.5 million; and
12 that issuance of long-term debt of \$3,050,000 to finance construction of a low volume wastewater
13 pond, on the various terms described in the filing is for lawful purposes, within the corporate powers
14 of AEPCO and compatible with the public interest, can only be made if:

15 1) AEPCO adopts a plan to improve its capital structure in the near future; and

16 2) The AEPCO/Staff agreed upon revenue requirement in the rate case is adopted.

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18 13. Staff recommends approval of AEPCO's request for the financings herein, contingent
19 upon the Commission's approval of the proposed/recommended revenues in the rate case and also
20 subject to AEPCO committing to adopt a plan concurrent with its rate case to improve its capital
21 structure by increasing the patronage equity portion to at least 30 percent. Staff further recommends
22 that AEPCO should provide to the Utilities Division Compliance Manager copies of all executed
23 financing documents within 60 days after the loan agreements are signed.

24 14. Based upon Staff's analysis, AEPCO's financial ratios indicate that AEPCO would not
25 have adequate earnings and cash flow to meet all its obligations unless it receives a rate increase in its
26 pending rate application. Additionally, Staff has concluded that this additional financing will
27 contribute to the further deterioration in AEPCO's equity ratio. We agree that AEPCO needs to
28 update its Capital Improvement Plan, and will address that issue in our Decision in the rate case.

1 Accordingly, we will require, as a condition to our approval of this financing, for AEPCO to comply
2 with our determinations therein, including the steps that need to be taken to improve AEPCO's
3 overall capital structure and financial condition.

4 CONCLUSIONS OF LAW

5 1. AEPCO is a public service corporation within the meaning of Article XV of the
6 Arizona Constitution and A.R.S. §§ 40-301, 40-302, and 40-303.

7 2. The Commission has jurisdiction over AEPCO and of the subject matter of the
8 application.

9 3. Notice of the application was given in accordance with the law.

10 4. The recommendations set forth in Findings of Fact No. 13 as modified herein are
11 reasonable and should be adopted.

12 5. The financings as approved herein are for lawful purposes within AEPCO's corporate
13 powers; are compatible with the public interest, with sound financial practices, and with the proper
14 performance by AEPCO of service as a public service corporation, and will not impair AEPCO's
15 ability to perform that service.

16 6. The financings approved herein are for the purposes stated in the application and are
17 reasonably necessary for those purposes, and such purposes are not, wholly or in part, reasonably
18 chargeable to operating expenses or to income.

19 ORDER

20 IT IS THEREFORE ORDERED that Arizona Electric Power Cooperative, Inc. is authorized
21 to borrow up to \$4.9 million from the National Rural Utilities Cooperative Finance Corporation under
22 the terms and conditions as set forth in the application and herein.

23 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is authorized to
24 borrow up to \$3.5 million on an interim basis, from the National Rural Utilities Cooperative Finance
25 Corporation under the terms and conditions as set forth in the application and herein.

26 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is authorized to
27 replace the interim financing with permanent financing from the Rural Utilities Service and the
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1 Federal Financing Bank, in an amount no greater than \$3,050,000 under the terms and conditions as
2 set forth in the application and herein.

3 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby
4 authorized to engage in any transactions and to execute any documents necessary to effectuate the
5 authorization granted herein.

6 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. is hereby
7 authorized to issue such liens or other security in relation to its property as may be required to secure
8 the borrowings.

9 IT IS FURTHER ORDERED that such authority is expressly contingent upon Arizona
10 Electric Power Cooperative, Inc.'s use of the proceeds for the purposes set forth in its application.

11 IT IS FURTHER ORDERED that approval of the financing set forth herein does not
12 constitute or imply approval or disapproval by the Commission of any particular expenditure of the
13 proceeds derived thereby for purposes of establishing just and reasonable rates.

14 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall provide to
15 the Utilities Division Compliance Manager copies of all executed financing documents within 60
16 days after the loan agreements are signed.

17 IT IS FURTHER ORDERED that Arizona Electric Power Cooperative, Inc. shall file with the
18 Commission copies of all executed financing documents setting forth the terms of the financing,
19 within 60 days of obtaining such financing.

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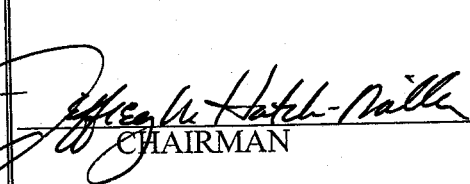
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IT IS FURTHER ORDERED that as a condition to these approvals for financing, Arizona Electric Power Cooperative, Inc. shall file with the Commission a capital plan as determined by the Commission in the Decision resulting from Arizona Electric Power Cooperative, Inc.'s pending rate application, Docket No. E-01773A-04-0528, and shall comply with any other requirements contained therein.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.


CHAIRMAN

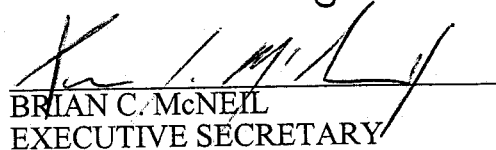

COMMISSIONER


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IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 17th day of Aug., 2005.


BRIAN C. McNEIL
EXECUTIVE SECRETARY

DISSENT _____

DISSENT _____

JR:mlj

1 SERVICE LIST FOR: ARIZONA ELECTRIC POWER COOPERATIVE, INC.

2 DOCKET NO. W-01773A-04-0793

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